

Structuring

FIRST ETF LISTED IN THE EMIRATES

In March 2010, National Bank of Abu Dhabi established the first ETF listed in the Emirates. The listing is a clear signal that this region will become a new hot spot for the ETF business. Get a greater insight on the ETF itself and its investment strategy, the challenges in establishing the ETF and focuses on questions as to why the ETF is structured as a UCITS and why domiciled in Ireland.



BY BRIAN KELLIHER | PARTNER | DILLON EUSTACE | DUBLIN

The Exchange Traded Fund, titled NBAD OneShare Dow Jones UAE 25 ETF, is a sub-fund of an Irish domiciled open ended umbrella collective investment scheme authorised as a UCITS by the Irish Financial Services Regulatory Authority (the “Irish Financial Regulator”). The United Arab Emirates Dirham Class of the ETF is listed on the Abu Dhabi Securities Exchange (the “ADX”) which constitutes the Arab world’s second largest bourse by market capitalisation. Consequently investors may buy shares of the ETF through brokers registered with the ADX.

The anatomy of the new ETF

The investment objective of the Exchange Traded Fund is to provide long term capital appreciation through the replication of the performance of the Dow Jones UAE 25 Total Return Index (Local). The ETF synthetically replicates the performance of the Index through a fully funded total return swap. The Index comprises the 25 largest, most frequently traded and liquid equity securities on the stock exchanges of the UAE, excluding foreign-listed stocks. To be eligible for inclusion in the Index, securities must have a minimum average daily trading volume of US\$ 500,000. Initially the ETF will gain exposure to heavy weights such as Emirates Telecommunications Corp, First Gulf Bank, Emaar Properties, NBAD and Dubai Islamic Bank. The

Index reflects the broad view of the UAE in a single index although represented exchanges are the Dubai Financial Market, Abu Dhabi Securities Exchange and Nasdaq Dubai. The Index is weighted by free-float market capitalisation. The weights of the individual components are capped to eight per cent of the Index. Components with weights of five per cent or more are restricted in aggregate to 40 per cent of the Index.

Facing some challenges

Before an application for authorisation of a UCITS may be considered by the Irish Financial Regulator, the latter must be satisfied that the promoter of the UCITS is acceptable to it. In this regard, NBAD had little difficulty in gaining approval given its status as the No. 1 bank in the UAE, its credit rating, its financial resources and demonstrable and relevant track record in the promotion of funds.

The UCITS Directive imposes two principal requirements where the asset management of a UCITS is delegated to a third party investment manager. Firstly, only investment managers, who are authorised or registered for the purpose of asset management and who are subject to prudential supervision (equivalent to that in the EU) may be appointed. Secondly, where a non-EU

investment manager is appointed, there must be a form of co-operation in place between the Irish Financial Regulator and the supervisory authorities of the third »

FUND FACTS

NBAD OneShare Dow Jones UAE 25 ETF

Underlying:

Dow Jones UAE Total Return Index

Index Sponsor:

Dow Jones Indexes/CME Group Index Services LLC

Listing:

Abu Dhabi Securities Exchange (ADX)

Market Cap (Millions):

USD 16.354

Issuer:

National Bank of Abu Dhabi

Domicile:

Ireland (UCTIS III)

Launch date:

March 25, 2010

Source: ETF Radar Global Research

Structuring

country investment manager. Given NBAD, Asset Management Group was the first entity from the UAE seeking approval to act as an investment manager of Irish domiciled funds, it was inevitable that it would take some time before the Irish Financial Regulator became reasonably satisfied that NBAD was subject to prudential supervision equivalent to that of a credit institution in the EU.

In addition, given it was proposed that NBAD, Financial Markets Division would act as the OTC counterparty to the fully funded total return swap entered into by the ETF, it was necessary to obtain the Irish Financial Regulator's approval for that entity to act as OTC counterparty. In this regard, the Irish Financial Regulator took comfort from » the facts that NBAD is the No. 1 bank in the UAE and from its rating of senior long term/short term A+/A-1 by Standard & Poor's, Aa3/P1 by Moodys and AA-/F1+ by Fitch giving it one of the strongest combined rating of any Middle Eastern financial institution. However, as a result of NBAD, Financial Markets Division acting as counterparty to the OTC swap, the ETF may not have any other direct exposure to NBAD or any related party of NBAD either through direct investments or through the receipt of collateral.

“National Bank of Abu Dhabi followed in the footsteps of the major ETF providers such as iShares, db x-trackers, Lyxor, Source etc. in establishing the NBAD OneShare Dow Jones UAE 25 ETF as a UCITS fund, domiciled in Ireland.”

As stated above, the ETF gains exposure to the Index through a fully funded total return swap pursuant to which, the ETF delivered at inception an amount equal to the net asset value of the ETF to the OTC counterparty in return for which the ETF receives an equity amount based on the performance of the Index. However, in order to minimise the ETF's counterparty credit exposure to below 5% of the net asset value of the ETF, the OTC counterparty was required to transfer UCITS eligible collateral against the equity amount owed to the ETF. Acceptable collateral to the Irish Financial Regulator which may be posted with the ETF in order to reduce counterparty exposure includes cash; government or other public securities rated at least A by Standard & Poors; certificates of deposit issued by certain credit institutions where the certificates are rated at least with an “A” by Standard & Poors; and bonds/commercial paper issued by certain credit institutions and non-bank issuers where the issue and issuer are rated at least A by Standard & Poors; and equity securities traded on a stock exchange in the EEA, Switzerland, Canada, Japan, the United States, Jersey, Guernsey, the Isle of Man, Australia or New Zealand subject to an “add-on” such that the market value of any

such equity share collateral represents 120% of the related counterparty risk exposure (i.e. a 20% “haircut”).

Why Structure as a UCITS?

80% of Irish domiciled fund are UCITS. To date all ETFs in Ireland have been set up under the UCITS regime. In this regard, NBAD followed in the footsteps of the major ETF providers such as iShares, db x-trackers, Lyxor, Source etc. in establishing the NBAD OneShare Dow Jones UAE 25 ETF as a UCITS fund. UCITS is a pan-European fund product which, once established in Ireland can be sold cross-border within the EU / EEA under a harmonised legislative framework without any requirement for additional authorisation. It is expected that the recently adopted UCITS IV Directive which is expected to be implemented into Irish law before July, 2011 will dramatically simplify the cross-border notification process within the EU / EEA. In addition UCITS is a global brand recognised worldwide as a robust, well-regulated product attracting investment from within, and from a wide range of jurisdictions outside, the EU. For example, Hong Kong, Japan, Taiwan and many South American jurisdictions, as well as non-EU European jurisdictions such as Switzerland, readily accept UCITS

for inward sale. As with any other UCITS product, NBAD OneShare Dow Jones UAE 25 ETF must comply with the various UCITS investment rules, including those relating to index replication. In this regard, the Index meets the applicable regulatory criteria on the basis that the weightings of the constituents of the Index are sufficiently diversified, the Index represents an adequate benchmark for UAE market and the Index is published in an appropriate manner.

Why Ireland?

Ireland is a major international fund domicile and administration centre, servicing assets worth €1.4 trillion in over 10,300 funds as of December 2009. Over 350 fund promoters from across five continents have chosen Ireland as their location to establish and service their investment funds. Irish funds are distributed to shareholders in over seventy countries, making Ireland a truly global hub for investment funds. In relation to ETFs, Ireland is a leading European fund domicile for internationally distributed ETFs. As of January 2010, total assets of European ETFs was Euro 157 billion of which Euro 44 billion represented Irish domiciled ETFs. ■